

The public-private-partnership “fetish”: moving beyond the rhetoric

Le « fétiche » des partenariats public-privé : au delà de la rhétorique

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Article abstract

Public-private partnerships (P3s) encompass a broad range of commercial and financial activity involving state engagement of for-profit firms to either provide or partially finance publicly prescribed services through long-term contracts. Following Marx's analysis of commodities, P3s can also be understood as a fetish - objects considered valuable because of the imaginary social relations that they imply as opposed to their usefulness. In this case, it refers to the transformation of instruments for meeting public obligations into some form or another of private property. It must be acknowledged that states have long employed P3 arrangements to provide instruments needed to meet their obligations. However, the scope of activities which governments are willing to consider open to P3s has grown to unprecedented levels. So eager are states to do deals and so prominent are such deals in their financial rhetoric, that P3s can now also be considered a fetish in the second sense of the word : Some thing or some activity that people have an irrational desire to have or to do. Most political-economy studies of P3s have focused on this rhetoric. They are attempting to understand the trend by relating this fetish to the political ideological agenda of neoliberalism. While valuable, this concentration has caused an equally critical question to be neglected. Why would investors want to take part in P3s ? The paper argues that to understand the P3 fetish we have to consider the dilemma facing pension fund managers during the late 1990s. An imbalance in supply and demand for high quality bonds and dividend paying stocks emerged due to declining public debts, management practices at large corporations, and an increasingly aging population. P3s provided a solution to this dilemma. The evaporation of this economic context and a growing public awareness of the costs of these deals likely mean that P3s will lose their status as a fetish in both senses of the word.



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Daniel Cohn

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Introduction

In Volume 1 of *Capital*, Marx struggled to come to grips with the change that takes place in things when they are acted upon by human labour. Once labour is applied to the products of nature, so as to make them useful for humans, they become commodities. However, it is not the usefulness by which the values of commodities are measured but by the social relations that are imbedded in their character. Marx described the mental process of transforming our understanding of things into relations among humans (which underlies this method of measuring the value of commodities) as the “commodity fetish” (1977: 163-177). This is because we are required to step outside of the material world of usefulness and enter the socially constructed world of human imagination in order to make these judgments as to the value of commodities.

Public-private partnerships (P3s) can also be understood as a fetish (objects considered valuable because of the imaginary social relations that they imply, as opposed to their usefulness). P3s encompass a broad range of commercial and financial activity involving state engagement of for-profit firms to provide, or partially finance, publicly prescribed services through long-term contracts. Essentially, P3s are instruments for meeting the obligations of the state (things that there has been a strong social consensus that the state ought to do) that are transformed so as to involve private property ownership as a key element in the operation of the instrument. As a result of this transformation, P3s carry a social meaning that, although it is imaginary, gives them a different value from the usual mechanisms by which state obligations are met.

Some might question whether P3s are actually anything new. At a certain level these critics are correct. The western liberal capitalist democratic states (henceforward WLCD states) have substantial experience with engaging private firms to aid in the meeting of their obligations. Some of these arrangements can and should be considered to be P3s. However, the scope of activities and the critical importance of endeavors that governments are willing to consider open to P3s has grown to a level not seen since the great transportation infrastructure-building era that produced transcontinental railways and trans-oceanic canals (see for example Waite 1971). Given the difference in scale and scope of the state's obligations when compared to this previous golden age of P3s, the present situation is unprecedented. So eager are state actors to do deals and so prominent are such deals in their financial rhetoric, that P3s can also be said to meet the more common definition of a fetish: things people are eager to do or objects they desire for no apparently rational reason. Linder (2000:19) perhaps more gently hits on this point when he describes “partnerships” as a “de rigueur reform.”

Most political-economy studies that seek to understand the emergence of P3s as a “de rigueur reform”, both in Canada and abroad, have focused on the rhetoric of state actors. These studies relate the rise of P3s to the political ideological agenda of neoliberalism. These authors either see P3s as an attempt to translate neoliberal ideology into practice or as a response by neoliberalism's opponents to the challenges that this ideology poses to the state (see for example, Bradford 2003; Ruane 2002; Shaw 2003; Linder 2000). Without directly referencing neoliberalism, the P3 trend is also sometimes understood as a mechanism for coping with the financial crises many governments have created for themselves by establishing both continuously falling taxes and balanced budgets as the primary benchmarks by which the public ought to judge their performance. In this regard, one of the bluntest explanations for the emergence of the P3 fetish in any jurisdiction comes from the Ontario Hospital Association:

The public-private partnership model is being adopted as an option for the primary reason of securing additional funding capacity to meet service needs, without negatively affecting the government's balance sheet. Although upfront payments are avoided it does not avoid the issue of having to pay for services or facilities - it merely transfers the obligation to annual operating costs (2003: 55).

In other words, the allegation being made is that the interest shown in P3s by the previous Progressive Conservative government of Ontario was driven by a desire to make public accounts appear better than they actual were. This was done in much the same way that Enron disguised its massive debts by describing its borrowing as long-term contracts to purchase supplies and lease equipment. The Province of Ontario has tried to “hide debt” by entering into long-term leases with private investors for new hospitals.¹

While valuable, this concentration on the rhetoric and motivations of the state has been at the expense of research on the other fundamental part of the P3 equation: why would capitalist investors want to finance, operate, or own assets that derive their value from P3s in whole or in part? The answer to this question might seem obvious - they want to make money. However, it becomes a far more interesting question if we accept that P3s are a fetish in the sense that Marx used the word (an object that has a worth determined by the social relationships that it embodies, not its usefulness). Any investor in a scheme that produces a product or service for the state that is priced according to the social relations that characterize the product or service runs a risk that the bargain might come undone if the difference between cost and usefulness is subsequently recognized to be significant and to the disadvantage of the public. Opponents within the political process and civil society will often attempt to bring such recognition to the public. This risk is taken very seriously by investors in P3s and by the financial advisors that help structure such deals (Macquarie North America 2001: 63). Some investors even claim that they will not participate in projects unless they offer the state sponsor a reasonable bargain (Lewis 2004).² However, it must be recognized that what constitutes a reasonable bargain will vary depending on where one is standing.

In the case of Canada, the question becomes doubly interesting when the large role that pension funds play as investors in the P3 market is recognized. These funds tend to be risk adverse rather than speculative investors. The Quebec Pension Plan (La Caisse de dépôt et placement du Québec) Canada Pension Plan, Ontario Teachers' Pension Plan, Ontario Municipal Employees' Retirement System, as well as the Teamsters' and British Columbia construction trades' pension plans are just a few of the big name funds active in the Canadian P3 market. Meanwhile, many other pension plans - as well as pooled and mutual funds that serve the needs of individuals saving for retirement - participate indirectly through investments in limited partnerships established to pursue P3s (Chenery 2001; Gerard 1999; Hogben 2003; Greenwood 2003; Lewis 2004; Loinc 2002; Macquarie Bank 2004).

The argument advanced in this paper is that the rise of P3s is the result of a dilemma facing the capitalist executives who control and advise the vehicles that allow Canadians to save for retirement. Although a rather crude simplification, these individuals and institutions will be referred to here as pension managers and pension funds.

As a group, the beneficiaries that pension managers serve are aging. According to investment theory, this requires managers to shift a greater proportion of the assets that they manage into more secure income-yielding investments, such as investment grade bonds and companies with a reliable ability to pay dividends.³ However, as will be shown below, during the late 1990s and early years of the new millennium these become harder to find. Meanwhile, the income-yielding investments that did become available paid relatively low interest rates. These problems have been magnified to a certain degree by laws that prohibit pension funds from investing more than 30 percent of assets outside of Canada.⁴ It will be argued that pension managers became involved in financing P3s as part of a solution to their dilemma. Not only did P3s give pension money a needed home, but furthermore, the additional risks supposedly undertaken justified demands for higher yields than those being offered to investors in ordinary public debts. Finally, the same low interest rates made it possible to participate in P3s and structure them so as to at least reasonably approach the usefulness that could be achieved had the project been undertaken traditionally, thereby reducing some of the political risk in these projects. Consequently, P3s solve both of the problems facing pension managers: the availability of income investments and their low yields. As long as interest rates stay low, the interest rate spread between public and private debt remains narrow, other income-yielding investments are hard to find in Canada, and state actors (as well as the publics that they serve) remain relatively unconscious of the true costs of the deals they are doing, then the P3 fetish will live on.

The next section of the paper provides a brief introduction to P3s. Section three takes a deeper look at the dilemma facing pension managers and explores the conditions that make P3s a good investment for pension funds and those that do not. This section makes the argument that the time was ripe for P3s as Canada approached the millennium. Section four forms a conclusion by looking at conditions today and by offering some speculation about the future. It is suggested that the conditions necessary for pension funds to invest in P3s are eroding.

A brief introduction to the philosophy of P3s

In the introductory section, it was stated that P3s are alternative arrangements for creating the instruments that states require to meet their obligations (things that there has been a strong social consensus that the state ought to do). These arrangements have been transformed so as to involve private property ownership. As a result, P3s carry a social meaning that, although it is imaginary, gives them a different value from the usual instruments developed to meet state obligations. This section serves to unpack this statement by looking at how the mechanisms necessary for meeting the obligations of the state can be transformed so as to involve private property ownership in alternative social relationships to those usually in place. This will be accomplished by exploring how WLCD states have traditionally involved private property ownership in the meeting of their obligations and the ways in which P3s differ.

Before proceeding, it is important to describe in everyday terms the sort of relationships that exist in a P3. At one end of the scale of complexity are so called design, fund, build operate (DFBO) arrangements. A private firm is engaged to deliver a service and all needed infrastructure for either a regular lease payment, or the right to collect

revenue from the service, or even some alternative payment (for example, the right to use land freed up as a result of redevelopment), or some combination of the above. Most of the hospitals built using a P3 process in the United Kingdom are of this type (Canadian Council for Public-Private Partnerships 2003: 29). In the case of urban transit, which is rarely viable on a market basis, the state often pays a subsidy to offset construction and/or operating costs (Macquarie North America 2001: 33-43). These contracts tend to be too big and complex for any one firm to undertake. Therefore, consortiums form to bid on them. The partners in these consortiums usually create a special purpose corporation that will carry out the project if their bid is selected. Given the scale of such undertakings, DFBOs also tend to involve very long-term contracts, often extending to the useful life of the facilities involved. The competing consortiums offer rival plans on how they would help the state fulfill its obligations, rather than simply tender to build something pre-designed by the state (Calder 2004; Macquarie North America 2001:4-5). Pension funds sometimes finance these special purpose corporations by taking a share in their ownership or by lending them money either directly or through participation in a bond issue.

At the other end of the P3 complexity scale are quasi-governmental organizations (such as universities) that have been freed by the state to issue their own bonds and credit notes. These become P3s when the terms attached to the bonds are so detailed, and the restrictions as to how money can be used are so strict, as to make the bondholders virtual co-owners of the organization.⁵ In between these two extremes is a wide variety of other possible arrangements. So why are these arrangements so different from the traditional means by which the state has engaged private property owners to help it meet its obligations?

Hood (1983) argues that states have four sets of tools for collecting resources and for deploying these resources to achieve their goals. In ascending order of cost and effort required to employ them, these four categories of tools are nodality, authority, treasure, and organization. States both collect information and disseminate it to society relatively effortlessly because they sit at the intersection of a variety of networks. By deciding what information to collect and what to pass on, the state can fundamentally change how we think about society as a people and what we choose to do. The state also grants tokens of authority to different actors and organizations, empowering them to collect resources for it and to act on its behalf. States use their treasure both to buy goods and services and to create financial inducements that encourage both individuals and organizations to act in ways that will further public objectives. Finally, the state is an organization with personnel, infrastructure, and property at its disposal that can be employed to collect necessary resources or to undertake tasks.

Private property ownership (the right to determine the disposition of both productive property and the surplus value that it creates) has primarily been involved in the work of the WLCD state in connection with the use of the tools of authority and treasure. It is worth beginning with the state's use of treasure as this might be the most familiar of the two tools. The state, like any other organization, needs to procure resources that others are better able to produce, so it uses its treasure to enter into contracts for their provision. Similarly, there are some tasks that the state needs fulfilled to meet its obligations to society that others are better able to do, so it contracts the work out. In some cases, the state also offers inducements so that private property owners will dispose of their property in a manner that advances public goals that the state cannot achieve alone or prefers not to undertake. Canada's income tax laws represent a catalogue of such inducements. In each of these three cases, the state has essentially created property. Whether it is granting a contract that gives the holder the right to sell resources to the state, to carry out work on the state's behalf, or benefit from some inducement, these rights can be bought, sold, and otherwise assigned (unless such transfer is explicitly excluded in terms of the contract or laws).

Tokens of authority are a little more complex. If we go back in time, we can find many instances of states granting ownership rights in terms of tokens of authority used to raise resources for the state. A good example of such an arrangement was the practice of "tax farming" that was common in pre-revolutionary Europe (Kiser and Kane 2001). In the modern era, the most obvious example of this creation of property through the granting of authority to raise resources for the state is the role that "primary dealers" play in the auctioning - (and subsequent reselling) of government bonds in many major countries (Breuer 1999; Dupont and Sack 1999). For example, in Canada only securities firms designated as primary dealers by the Bank of Canada may take part in the auctions that set the price and yield that new federal government debt issues will initially trade at in financial markets. Any other institutional or corporate investors that wish to acquire government of Canada bonds must buy them from the primary dealers (Bank of Canada 1998).⁶

States have also created private-property rights in the tokens of authority used to carry out the work of government. In Canada the countless variety of licenses and certificates needed as part of everyday life are often obtained from private firms that have been granted the tokens of authority that allow them to sell these licenses and certificates. For example, in provinces that require a vehicle inspection before registering a change of ownership for a vehicle, most auto repair shops are authorized to conduct such inspections and issue the necessary safety inspection certificate. In British Columbia, the license plates themselves (and annual renewal stickers) are issued by private insurance agencies that serve as representatives of Autoplan (the public insurance corporation).

These above examples, showing how the WLCD states have involved private-property ownership in order to carry out their obligations, lack some or all of the defining characteristics of P3s. To understand why this is the case, we must

first carefully consider what the word partnership means. It can be used in a loose sense to mean any two entities that have a relationship. However, in its more literal sense, it means a relationship based on common goals where both entities share benefits and contribute resources over the long-term for both mutual advantage and out of a sense of commitment. This is the sense in which supporters of P3s use the word to describe these arrangements. Those who are opponents or more ambivalent about P3s use this sense of the word to describe how P3s would operate if they did in fact represent undertakings of benefit to the public (Roseneau 2000: 219). In a P3 the common goal is a publicly agreed outcome (e.g. improvements to infrastructure or the building of a new health centre) and the degree to which each partner is obliged to contribute and receive rewards is based in the size, severity, and types of risks each partner agrees to assume (Taylor et al. 2001: 40). In other words, risk (at least in theory) is the measuring stick by which the social relationships embodying P3s are valued, rather than the usefulness of the instruments that are being created to meet the state's obligations to society.

A further element of partnerships is trust (Taylor et al. 2001: 41). Trust, and the way it is created (both in society at large and in the relationships between business partners) has been a topic of extensive academic writing (for recent examples see Fukuyama 1995a and 1995b; Putnam 2000; Uslaner 2002). Das and Teng (2004) argue that subjective trust, one's appreciation of how trustworthy an organization or person is and behavioural trust, our decision to trust an organization or person, are in fact mirror images of the perceived risk we feel a relationship entails and the risk-taking behaviour we engage in by entering such relationships. While trust clearly has deeper roots than the terms of any written contract (roots found in shared cultural understandings as to what is ethical and legal structures that are available to enforce any written contract) contract terms can also encourage or discourage trust and therefore willingness to take risks (Ertel 2004). One such element that can encourage trust among private investors is a commitment that the state will not set up competition that undermines the value of proposed investment. This is why P3 contracts often contain language that grants the arrangement that the private partners are investing in what amounts to either a functional or spatial monopoly (Engineering News Record 2002).⁷ In a sense, such monopoly grants are understandable. If the service or infrastructure could be provided profitably on a competitive basis, there would be little need for such comprehensive public involvement in its provision.

With this in mind, it is clear as to why tendering and contracting-out exercises do not constitute P3s. In general, these relationships are not meant to be long-term, but rather, such contracts are subject to frequent re-bidding. Further, in such exercises, the private party plays little role in defining the project. Rather, they agree to undertake work assigned by the state for a fee. Similarly, the granting of property rights via the issuances of tokens of authority (discussed above) does not qualify as a P3. Those issued such tokens generally must compete against other token holders so as to generate a profit from their investment in the token; also, the token holders generally do not help define the projects that they are participating in.

It is the private partner's willingness to accept risk (by staking capital to acquire an ownership share in the project) and not the usefulness of the project that is said to justify the additional rewards that the private partner gains when a project for meeting public obligations is transformed into a P3. However, usefulness and the value it represents to the state cannot be ignored either. As noted above, if the costs of the project and its useful value to the state are too out of proportion, the project will probably be repudiated and fail. This political risk is just one of the many different types of risks that the public can share with the private partner(s) in a project. According to Akawi (2001), adequately quantifying these risks and then developing a model that transfers those risks that the public partner does not wish to bear to the private partner at a reasonable price is at the heart of any good P3 contract. In his article, he specifically describes the following risks:

Project risk

The capital costs of the project might turn out to be greater than estimated, or the project might take longer to create than anticipated.

Operating risk

The operating costs of the project might turn out to be greater than estimated.

Technical risk

The project might not work as well as expected or might suffer some sort of failure, either of which would impose the need for spending on other projects.

Financing risk

The costs of acquiring the money needed to create and/or operate the project might be higher than estimated.

Regulatory risk

Changes in regulations that necessitate future modifications, such as new safety standards, might impose costs on the project over its lifetime.

Public policy risk

Changes in public policy might reduce the need for the project. Imagine building a highway to relieve congestion, then subsequently raising gasoline taxes to encourage transit use.

Political/legal risk

The government may determine that the project is not in the public interest and either force modification or cancel it. Alternatively, legal objections brought either by public, market, or civil actors might handicap the project.

Force majeure

The project might be seriously damaged or destroyed by events beyond control. Although Akawi does not mention this, we should also include the risks arising from acts of war or terrorism in this category.

To this list can also be added “demand risk”, the anticipated customers or users for the project might never emerge, either for reasons beyond the control of any of the partners or the malfeasance of some or all of them. This is important, as the P3 model is often seen as especially useful when the project can be expected to pay all or some of its way by generating its own revenue (such as with a toll-highway or transit line). However, demand is also one of the most difficult risks to allocate (Taylor et al. 2001: 83) or even assess.

Consider the following: The Greater Vancouver Transit Authority (GVTA) is presently considering the building of a new transit line to Vancouver International Airport and the adjoining suburb of Richmond using a DBFO P3 model. The private operator would partially finance and completely own and operate the line. Anticipated ridership is clearly a key factor in determining whether or not the project will generate the funds needed to pay back the private capital costs and allow an operating profit. However, ridership also depends on actions undertaken both by the state and private partners. For example, if the trains fail to run on time (the private partner’s obligation) ridership might decline. If the buses connecting to the line fail to run on time (the GVTA’s obligation) ridership might also fall. These sorts of failings might seem easy enough to avoid if service standards for both the trains and buses are specified in the contract. However, what if the problem is subtler, such as ridership declining due to a lack of cleanliness or a perception that the transit system in general is crime-ridden? The same project also provides a good example of the difficulty presented in simply attempting to assess raw demand, even if the project works relatively flawlessly. The ridership forecasts prepared for this proposed project have a margin of error of plus or minus 15 percent for normal commuter traffic and plus or minus 20 percent for airport users (Jacobsen 2003: 11).

The methodologies employed in the calculation of risks and the monetary value associated with any transfer of risk are always complex, subjective, and often less than transparent; they are also sometimes proprietary secrets. Given the imprecise nature of the methods used to assess and value risk, there is a fair probability that so-called super-profits will occur (Macquarie North America 2001: 44-45). Super-profits are those that greatly exceed the rate of return considered normal for a project of a given sort with a given risk profile. With the exception of the dwindling number of utility industries where rates of return are regulated, there is no prohibition on firms earning as large a profit as they can, provided that they do so within the bounds of the law. Therefore, the issue of super-profits is really a question of politics and one that has to be answered by the state contracting for a P3, not by the contractor. Super-profits imply that the state involved in a P3 paid an undue premium to its private partners in order to transfer risk to them. This can also be understood as the state having accepted an undue risk of forgone revenue.

If super-profits emerge, political opponents will allege that sharp dealing or improprieties occurred. This could indeed be the case, but such critics generally miss an even deeper problem with the use of risk-transfers. This basic flaw is that when monetized, risks in their entirety (including those presently known and presently unknown) form an equation that tends to self-balance over the long run and in aggregate across projects. In other words, a state can transfer a specific risk (associated with a specific project) to a specific partner or set of partners. From the point of view of these partners, these are genuine risks and they, therefore, demand a reward in the form of an anticipated profit margin for assuming them. However, the state will have to assume different risks of an equivalent value either in the specific contract in question or in some future one. This is especially the case if we include in this list the risk of over-paying private parties to assume other risks or unnecessarily risking foregone revenue. In the long -run, the state in question will end up holding risks of exactly the same monetary value as it began with, but it will be out of pocket for the transaction costs and the costs associated with the anticipated profit margin sought by private investors. The only way an equation of this sort will tend not to self-balance and create genuine long-term savings for the state is if one assumes the state can line up an infinite string of suckers to act as counter parties.

An everyday example that might help clarify the above idea is automobile insurance. Imagine a jurisdiction where there is no legal requirement for drivers or vehicle owners to carry insurance. If you buy insurance and never have an accident you have over-paid for insurance and your over-payment is equal to the entire amount of premiums you pay over your life. That risk of over-payment is a risk you take in buying insurance. Now suppose you have an accident, and worse, it is clearly your fault. This accident could well create a loss for your insurance company. That is the risk that they are taking in insuring you. However, if they do suffer a loss, then they are not going to just smile and walk away.

They will try to recoup their loss by raising their premiums, and they will limit future risks by reducing the amount of insurance cover they will provide. Other insurers will likely learn of your accident and only offer you insurance on similar terms. At an individual level, this probably does not bother you too much. First off, the risk of having an uninsured accident is an enormous financial threat to an individual family, so enormous that it is worth the risk of over-paying for insurance. Second, if your insurer suffers a big enough claim due to your behaviour as to incur a loss, it is very unlikely they will ever recoup the money from you personally as you will not live long enough to pay enough in premiums over enough years to balance the bill. This latter fact is precisely why insurance companies do not just base their premiums on your behaviour, but base it on the behaviour of all the people that they insure and the information they can gather about the entire population of drivers and the profits or losses of their competitors.

Now consider the situation of the state and P3s. First, states are not individuals, so the factors that make it worthwhile to err on the side of overpayment do not apply. If a state does one P3 project and the private partner suffers a loss through risk transference, then the state will come out ahead. However, states do not want to do just one, they want to do several and do them regularly. In this situation, the private investors will learn from this and price future bids higher in order to recoup their losses and prevent future ones. Alternately, they may be unwilling to accept risks as great as the ones they previously accepted. Other investors will also learn of this and similarly raise their prices and/or reduce their willingness to assume risks if asked to bid on P3s. Hence, the problem is that although the state can come out ahead by transferring the risks involved in any one project, in aggregate and over the long term, it can only come out ahead through this process if investors are irrational or misinformed. Nevertheless, such savings allegedly achieved through monetizing the value of risks transferred to private parties are often central to making the financial case for a P3. One study, funded by the British government, which examined 17 P3s in that country, found 60 percent of the savings public agencies expected to realize could be attributed to the monetized value of risk transfers. In some projects, anticipated savings were entirely attributable to risk transfers (Arthur Anderson and Enterprise LSE 2000).

In that the monetized value of risks ought to form a self-balancing equation, no real savings is possible to the state over the long run and in aggregate via risk transfer, although it is possible in a single individual project. In other words, it adds no usefulness to the mechanisms developed to meet state obligations. As a result, the act of risk taking via allocating direct private ownership in specific projects (the social relationship that marks out the P3 from other mechanisms employed for meeting state obligations) is as fully and subjectively constructed as any of the other social relationships that embody the character of commodities. The act of restructuring mechanisms for the meeting of state obligations to society so as to involve private ownership cannot alter the useful value of such mechanisms.

Having said that, perhaps one comment in favour of the risk-transfers that are supposedly at the heart of P3s is in order. While risk-transfers cannot change the usefulness of the infrastructure and services created to fulfill state obligations, the model might be able to prevent poorly conceived infrastructure and services from being created if employed properly. In that the proper development of a contract requires the state and its potential partners to explicitly calculate and monetize the various risks (in order to trade them) it is possible that the P3 model can help avoid the creation of white elephants and black holes. Consider whether the now nearly abandoned Mirabel airport outside of Montreal would have been built if required to undergo the sort of analysis needed to employ the P3 model?

Meanwhile, in May 2004 the GVTA temporarily killed the Richmond-Airport-Vancouver rapid transit project after analyzing the penultimate bids of the two finalists contending for the contract. Both these bids were so far over budget as to leave previously undecided councilors convinced that the project would require substantially more funding than had been authorized or lead to spur of the moment changes in performance criteria during construction. Consequently, they voted to terminate the project before going to the “best and final bids” stage so as to avoid any further obligations to the bidders (Skelton 2004). Would the rival consortiums have been so cautious in estimating the financials if they were simply bidding to build the system, rather than committing to successfully operate it as well for several decades to come? Still, the method can only save states from investing in black holes and white elephants if they choose to listen to the messages that the P3 bidding process produces. Unsatisfied with the GVTA’s decision to abandon the proposed project, provincial premier Gordon Campbell stepped in and authorized his transport minister to guarantee that the costs to the GVTA would not exceed its proposed budget, and the province, in turn, would assume control of the project. The province thereby announced its willingness to accept all the risks involved in the project that private partners were hesitant to assume within the budget set by the GVTA (Campbell and Falcon, 2004). After voting once more to reject the line (Lee 2004), the councilors approved restarting the tendering when the province accepted a revised approval process that would allow the GVTA to cancel the project entirely if neither of the final bidders could produce a design that met both the GVTA’s approved budget of \$1.35 billion and the performance criteria which the GVTA itself loosened (GVTA 2004).⁸

It is this (hopefully) careful specificity of risks that also gives the P3 value from the standpoint of investors. There are two ways to manage risk as an investor. One way is to invest in an endeavor with as wide a breadth as possible, such as an index comprising Canadian federal, provincial, municipal, and investment quality corporate bonds of different maturities. Each aspect of the Canadian economy presents risks that will emerge and recede at different times. In aggregate, they are too numerous to accurately assess. However, barring catastrophe (so called systemic risk) they also ought to cross-cancel to a considerable extent over the life of the investment, leaving a solid rate of return. The

other way to manage risk is to invest in as narrowly focused an endeavor as one can find so as to be able to assess all the risks involved as accurately as is possible.

P3s present just such an opportunity for pension managers to attempt to assess and understand the risks that they are assuming. This opportunity is further enhanced by the frequent strategy of creating special purpose companies for the specific task of partnering with the public sector for each project. For example, the province of British Columbia has entered the last phases of negotiation with "Access Health Abbotsford". This is a special purpose corporation set up by a consortium of partners in order to bid for and win the contract to construct a P3 hospital in the Vancouver suburb of Abbotsford. Partners in this special purpose corporation include the following: PCL Construction, facilities management firm BCLJC/Johnson Controls, catering-housekeeping firm Sodexo, international banking and investment fund management giant ABN-AMRO, as well as architectural and hospital engineering firms (Partnerships BC 2004). Special purpose corporations, limited by the terms of their incorporation to one specific project, are more likely to consistently pay out the dividends and/or interest payments that investors anticipate. This is because the managers of such corporations are prohibited from gambling away these funds on efforts to grow their firms. Such investments are often called "income yielding". It is to the question of why pension fund managers are so interested in income-yielding investments that we must now turn.

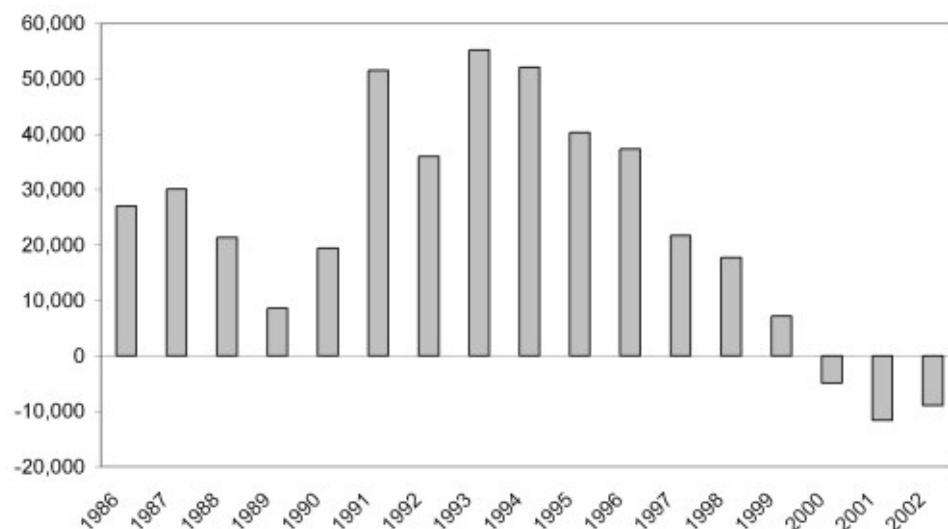
The hunt for income and the emergence of P3s

That Canada's workforce is aging is no secret. Over the 1990s, the workforce in large portions of the economy has edged closer to retirement age. This has implications for pension funds and the choices faced by the managers of these funds. These implications become even more serious when it is recognized that the sectors of the economy likely to be most severely and earliest hit by the baby-boomers' retirement wave- (for example, health, education, and managerial ranks throughout the private sector) are also those where employees have the highest participation rates in both employer sponsored and personal pension plans (MacKenzie and Dryburgh 2003: 7-8; Maser and Dufour 2002: 40).

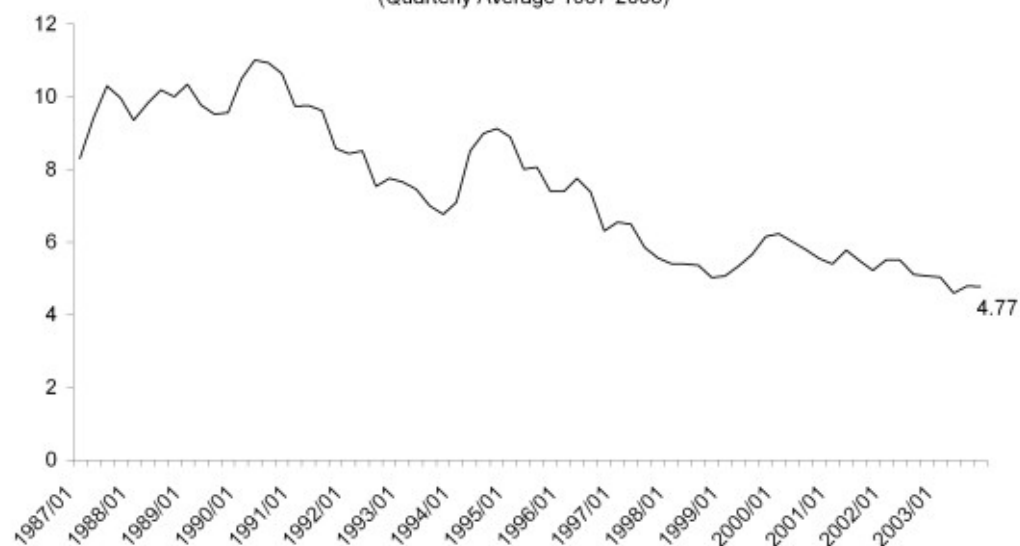
In order to understand the implications of this for pension fund managers, we have to consider the two general ways in which investors earn returns. These are capital gains and income. When an investor buys a security (be it a stock or a bond) and sells it for more than they paid for it, the difference in price is called a capital gain. When the investor receives interest on their investment or a dividend, it is called income. While it is difficult to predict when a specific stock or bond might rise (or fall) in value, income payments are generally more predictable. The terms of a bond are usually set a payment schedule that the borrower pledges to meet. Though changeable, dividends are almost as reliable. Markets interpret changing dividend levels as conveying either good or bad news about the health of the company (Grullon et al., 2002: 388). Therefore, managers tend to set dividends that their firms can sustain in spite of most contingencies.⁹ Credit quality comes into play with income investments as market actors will generally demand higher rewards for holding the securities of organizations that they perceive to be less likely to honour their payment schedules. Consequently, investors who are likely to need their money soon, and on a predictable schedule, are generally advised to balance their portfolio in favour of income-yielding investments issued by organizations with better credit quality. Those investors who do not need their money for a long time are advised to balance their portfolio in favour of investments that will produce capital gains and to not shy away from bonds or stocks issued by organizations with lower credit quality. Although the timing of rewards might be unpredictable, over the long-term, doing these two things is said to produce greater returns as a result of the risk premium markets demand that issuers pay to the holders of such assets (Ross et al. 1999: 369-392).

Given the workforce changes noted above, among other reasons, it should not come as any surprise that some observers believe we are at the start of an era that will see a widespread rebalancing of the portfolios held by employer sponsored pension funds. Funds will be moved away from investments that predominantly produce capital gains, toward those that predominantly produce income. So far, the scale of rebalancing has not been particularly large (McInerney 2004: 6). However, even a slight shift in the targeted asset allocations by pension managers can have big implications for markets. For example, Canada's employer sponsored pension plans held assets valued at \$817.6 billion in the year 2000 (Anderson 2003: 67). Therefore, if one were to use 2000 figures, demand for income-yielding investments would grow by approximately \$8.18 billion for every one percent shift in overall asset allocation among these plans. The problem is that supply of investment grade income-yielding investments has been drying up. Starting in 2000, Canadian governments became net redeemers of bonds, not issuers, as deficits were eliminated and total public debts were paid down. Meanwhile the yield on these bonds dropped substantially (see Figures 1 and 2).

Figure 1 Net New Bond Issues All Levels of Government (\$ Millions)



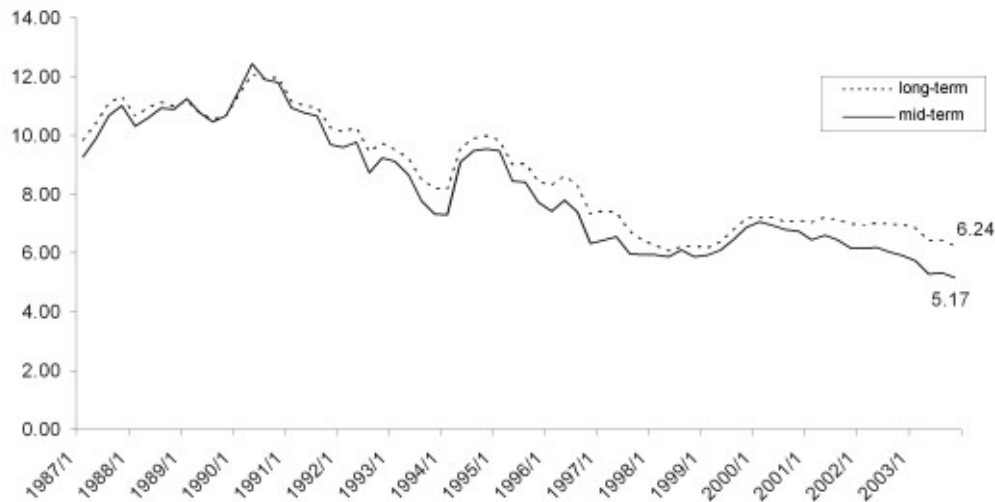
Source: Statistics Canada Cansim Data Base.

Figure 2 Percent Yield 10 Year Government of Canada Benchmark Bond
(Quarterly Average 1987-2003)

Source: Statistics Canada Cansim Data Base and Bank of Canada.

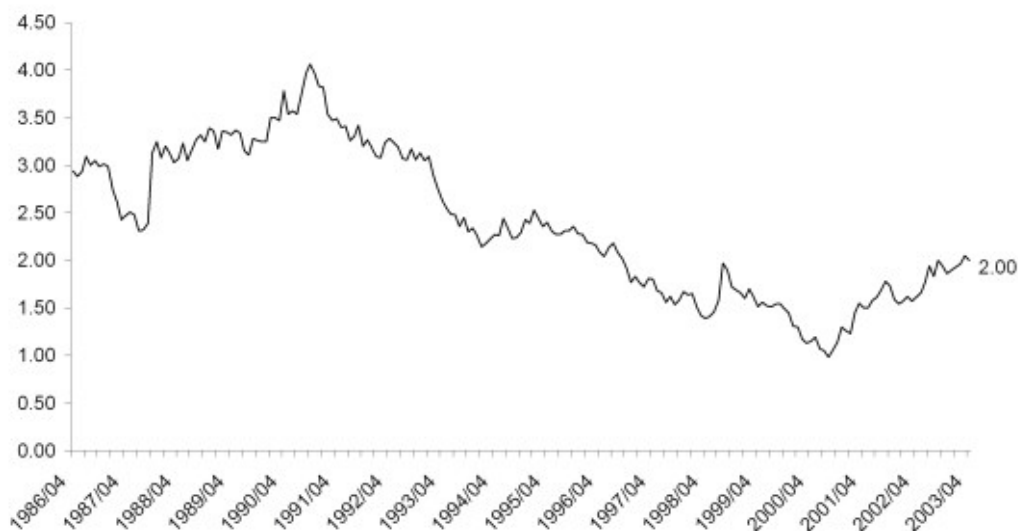
Corporations, facing less competition for investors, have been able to issue bonds on easier terms. Similarly, dividend income has become harder to come by as well. Corporations, for a variety of reasons, have chosen to reward shareholders primarily through capital gains rather than dividends in recent times (See Figures 3 and 4).

Figure 3 Percent Yield Corporate Bonds Scotia Capital Inc.
Average Weight All Corporations (Quarterly Averages 1987-2003)



Source: Statistics Canada Cansim Data Base and Bank of Canada.

Figure 4 Dividends Percent Yield Toronto Stock Exchange 300
(Monthly Average Calculation)



Source: Statistics Canada Cansim Data Base.

Making the whole situation worse was the disappearance of Canadian companies to invest in. In the late 1990s many foreign (predominantly US) firms took advantage of a weak Canadian dollar to buy out rivals, or they used the opportunity to buy-out shareholders in their Canadian subsidiaries. Either way, the net result was the same; an already thin Canadian market was made even thinner. Since Canadian pension managers can only invest 30 percent of their total assets outside of the country (up from 20 percent at the start of the 1990s) these managers found themselves picking from a constantly shrinking pool of smaller and riskier firms (Janigan, 2000). As a result, pension managers looking for income-yielding investments had to accept relatively low returns and be willing to invest in organizations and issues with lower credit quality. As with power, markets abhor a vacuum. With so many investors looking for income-yielding investments and being presented with so few and such poorly rewarding options, it was only natural for financial entrepreneurs to create new investment vehicles to meet their needs. The then president of the Ontario Municipal Employees' Retirement System is quoted by Drury (2002) as explaining his pension fund's interest in P3 infrastructure deals this way: "We need to pay pensions, retaining a portfolio of both traditional bond and equity returns as we do so. We use to finance such investments [as public infrastructure] with government bonds. But as the government no longer issues them we've learned to adapt."

As noted in the introductory section, many of Canada's large pension funds are already investing substantial amounts of money in P3 ventures. Although these investments already total in the billions, they pale beside the sums pension managers would like to invest if suitable projects could be found. For example, by 2003 the Ontario Municipal

Employees' Retirement System had exposure to investments of approximately \$1.2-1.3 billion in infrastructure projects through its Borealis subsidiary (most of which is represented by P3s). These include stakes in one of Ontario's nuclear power plants, schools in Nova Scotia, the Confederation Bridge (to Prince Edward Island) and two hospital buildings under construction in Ontario (Karleff 2004; Lin 2002: 16; Palmer 2003; Tomesco 2004). Meanwhile, the Ontario Teachers' Pension Plan reported a similar sized stake in the P3 market in 2003 (about \$1.5 billion). However, both organizations have indicated they would like to see such investments grow to represent 10 percent of their total portfolios, respectively tripling and quintupling their present investments (TD Economics 2004: 22; Ontario Employees' Retirement System 2004: 1; Ontario Teachers' Pension Plan 2004: 2).

The very same trends that made the last years of the 1990s and early years of this millennium a difficult time for pension managers searching for new income-yielding investments, also made it an ideal time for P3s. While riskier than traditional public bonds, they are less risky than income-yielding investments tied to the performance of corporations. This is because, as noted above, for the most part P3s are granted either a functional or spatial monopoly. Secondly, the low and declining interest rates of the era, combined with narrowing spreads between risk free public and more risky corporate bonds, allowed the investors seeking to develop P3s to competitively finance the creation, redevelopment, and/or management of infrastructure and services for states. Finally, this same interest rate trend also made P3s far more attractive investments.

It is generally accepted that any for-profit organization seeking to replace the public sector as a provider of infrastructure or services faces two major barriers in delivering a comparable product at the same or lower cost to the state. The first barrier is the need to make a profit on the transaction. The second barrier is the higher cost of capital that private organizations face in comparison to state organizations. As a result, the for-profit organization must develop strategies and techniques to perform the tasks involved in the contract with a far greater level of cost-effectiveness. This represents a significant challenge (Keenan 1999).

In fact, it would almost appear that the P3 industry has latched onto the fiction of public savings as a result of risk-transfers (savings which, as noted above, are unlikely to benefit the state if measured over the long-term and in aggregate). This fiction allows the P3 industry to justify the almost inevitably higher costs associated with P3s when operating on an "all other things being equal basis."¹⁰ Nevertheless, even getting costs down to the point where a slightly higher price can be justified by a claim that it is an appropriate reward given the risk-transfer involved is no small feat. When managers do accomplish it, their hard work and skill ought to be acknowledged. What might escape notice, however, is that the scale of the challenge is not static.

Imagine that a province wishes to employ the DBFO P3 strategy to create a new hospital. According to the terms of this hypothetical tender, the private partners will be expected to provide a building and all the non-medical support services. In fact, provinces are at various stages of acquiring hospitals on this sort of basis in Alberta, British Columbia, Ontario, and Quebec (Calder 2004). Let us assume that companies with specialties in each area covered by the tender come together to create a special purpose corporation to make a bid. To simplify matters, let us also assume that the only funding that this corporation needs has been provided through a bond issue that is sold in its entirety to a pension fund (which they might later resell part or all of to other investors). Above and beyond the cost of providing the hospital and support services specified in the contract, the consortium would have to factor in the costs of borrowing the necessary funds as well as the profit margin that they themselves expect when calculating their bid. In order to offer the public sector reasonable value (similarly useful facilities at a price close to that of a traditional public project on an all other things equal basis) they will have to find a way to reduce operating costs by something close to the total of these two factors. Now let's look at how the scale of their task changes depending on the economic conditions.

We can construct a relatively simple model that shows the cost savings that the operators of our fictional special purpose corporation have to approximate by looking at the spread between the yields on public and private bonds of similar duration and the profit margin investors would demand. In that the example being employed here is a hospital, the yield on the Scotia Capital long-term provincial bond index will be used as an indicator of the cost of capital to the state.¹¹ The yield on the Scotia Capital long-term corporate bond index will provide our indicator of the cost of private capital.¹² At a recent chamber of commerce forum held to discuss the construction of a highway tunnel under Vancouver's harbour, a leading expert on P3s stated that investors generally want to see a 15 percent return on investment (quoted in Barraclough 2002). While recognizing that this comment was specific to "dumb" infrastructure such as a tunnel and that a different rate might be appropriate for a staffed facility such as a hospital, this once again seems a reasonable number for illustrative purposes. As noted, this model is hypothetical. However, it does reflect real trends in interest rates and business requirements. Although different numbers might be used, they ought to produce a reasonably similar trend line.

Two factors generally impact on the cost of money provided through bond markets to corporations. These factors are the interest rate being paid on relatively risk free government bonds and the difference in credit quality between government and corporate borrowers that investors are willing to tolerate without demanding an increased risk premium. Therefore, in an era when provincial balance sheets are sound and businesses are facing a time of crisis, the spread will grow. When business conditions are sound and government balance sheets are weighed down, the gap will

shrink. Finally, the lower the absolute cost of corporate borrowing, the lower the burden of the 15 percent return will be. This is because it is not static, but it grows and falls proportionately with the interest rate it is levied on. If money costs you one percent, then you in turn must earn an additional 0.15 percent on it to earn a 15 percent profit. However, if money costs you two percent, then you in turn must earn an additional 0.30 percent on it to earn a 15 percent profit.

As can be seen in Table 1, the late 1990s were something of a golden age for those wanting to finance a P3. The gap between corporate and provincial credit costs was low; meanwhile declining interest rates added the further bonus of lessening the weight of the 15 percent return investors sought on their investments.

Table 1 Cost of Public vs. Private Money

Year	% Yield Scotia Capital Long-Term Prov. Index Annual Average	% Yield Scotia Capital Long-Term Corp. Index Annual Average	Plus 15%	Total % Spread (Cost over Prov.Funding)
1982	15.58	15.97	18.37	2.79
1983	12.62	12.73	14.64	2.02
1984	13.36	13.5	15.53	2.17
1985	11.69	11.79	13.56	1.87
1986	10.31	10.37	11.93	1.62
1987	10.61	10.7	12.31	1.7
1988	10.86	10.94	12.58	1.72
1989	10.49	10.8	12.42	1.93
1990	11.53	11.85	13.63	2.1
1991	10.6	10.85	12.48	1.88
1992	9.48	9.9	11.39	1.91
1993	8.56	8.87	10.2	1.64
1994	9.23	9.41	10.82	1.59
1995	8.92	9.08	10.44	1.52
1996	8	8.15	9.37	1.37
1997	6.81	6.99	8.04	1.23
1998	5.91	6.2	7.13	1.22
1999	6.18	6.64	7.64	1.46
2000	6.51	7.15	8.22	1.71
2001	6.36	7.1	8.17	1.81
2002	6.14	6.99	8.04	1.9
2003	5.71	6.5	7.48	1.77

Source: Statistics Canada Cansim Data Base and Bank of Canada.

This situation has partially reversed since 2000 because of declining provincial indebtedness and mounting investor concern over Canadian corporate credit-worthiness (whether justified or not) (Angastiniotis et al. 2004: 10-12; Vazza et al. 2002: 5). In other words, even though rates have remained relatively low, the cost of private (relative to public) capital has increased. To put this in perspective, imagine that our hypothetical consortium established a special purpose corporation to bid on a DBFO P3 hospital project in 1999. Now imagine that this project went reasonably well, so the province tendered for an identical second hospital in 2002. In order to deliver a comparable level of usefulness to the state, based on the figures in Table 1, the consortium would have to attempt to squeeze an additional 30 percent in annual savings out of the special purpose company created to deliver the second project.¹³ Still, even accepting that some widening of the gap has occurred, as long as absolute interest rates remain relatively low, then the second part of the equation (the multiplicative weight of the need to return 15 percent on investment) is kept in check.

The absolute level of interest rates themselves provides a further explanation for the enthusiasm pension managers have shown P3s in the last few years. With no inflation in sight, the higher than normal bond yields (justified by the “risk-transfer” involved) or the almost-guaranteed dividends involved in providing the P3s’ monopoly services, protected investors against any further decline in interest rates. However, a rising interest rate trend would make such locked-in returns less attractive, and in the case of dividend-yielding shares in P3s, managers would be required to squeeze out further cost-efficiencies to raise the dividend to match rising interest rates.

In sum, P3s offered pension funds and states an apparent win-win. For a little more cost, governments could stretch out payments and keep up the veneer of their claims to be providing the public with falling deficits and lower taxes.

Meanwhile, assuming cost savings could be found by the special purpose corporations assembled to deliver P3s, then the pension funds could earn a bit better return than a traditional government bond and possibly dividends if they took an equity stake in projects as well. Finally, as long as the cost difference between traditional projects and P3s was relatively narrow, this additional cost could be explained to the public as a reasonable bargain given the supposed risk transfers involved. This is of course in spite of the problem that, in the long-run and in aggregate, the state cannot realize lower costs through risk transfers; even though it might do so in the case of individual projects. As long as interest rates remain low and offerings of income-yielding investments remain sparse, then pension fund managers have every reason to continue to participate in P3s.

Is interest in P3s in decline: a conclusion or an epilogue?

At the end of the 1990s, pension fund managers needed a new form of income-yielding investment, and the economic conditions were such that they could offer to fund P3s on attractive terms. The cost of private capital relative to public capital and the overall low level of interest rates meant that they could participate in consortiums created to deliver infrastructure at prices close to the cost that would prevail if public capital had been used. Whatever extra cost was involved could be ascribed to the risks transferred to the private partners in the project. However, there is a good possibility that this golden era of Canadian P3s is now over. A number of prominent deals had to be taken off the table when it proved difficult for the consortiums bidding on projects to approach the cost of carrying out these projects within estimated budgets or with a cost reasonably similar to that of traditional public procurement. In some cases, bidders are actually walking away. This has occurred in spite of prominent political support for such deals by neoliberal governments.

A look at some of the major attempts to use the P3 process in British Columbia helps demonstrate this. In 2001, the BC Liberals came to power with Gordon Campbell as premier. The government implemented a stereotypical neoliberal program similar to that adopted previously in provinces such as Ontario and Alberta. The government soon began to express “zealous enthusiasm” in using the P3 model wherever feasible for the provision of infrastructure and services (Tafler 2002: 16). Nevertheless, the government’s first prominently proposed DBFO tenders rapidly collapsed. After entering negotiations with a finalist to build an extension to Vancouver’s convention centre for the 2010 Olympics, the government admitted the P3 model would be too costly, and it adopted a traditional public sector approach (Constantineau 2003). Meanwhile, as noted previously, the GVTA’s proposed Richmond-Airport-Vancouver rapid transit project was nearly killed when neither of the two finalists in the bidding process seemed able to complete the project within the proposed budgetary limits (Skelton 2004).

A third prominent DBFO project is also proceeding under less than ideal circumstances. This is the attempt to use the P3 model to procure a new hospital for the Vancouver suburb of Abbotsford. As discussed previously, the province has entered into final negotiations with a special purpose company called Access Health Abbotsford. However, Access Health Abbotsford won this position partly by default. The other finalist bidder, The Healthcare Infrastructure Company of Canada, chose not to submit a final bid and withdrew from the contest. This left the province to conduct a competitive bidding process with only a single bidder (Leslie 2004). While technically possible, this is hardly the market situation that economic theory suggests will lead to a low price. As well as these DBFO miscues, some mention must also be made of the government’s attempt to use a P3 model to lease the province’s only toll highway to a private operator. When it became known that the project would only be viable if tolls were increased by 30 percent, political pressure killed the idea (McInnes 2003).

It is indeed possible that the above noted projects all fell into difficulty because they were ill conceived, as most had credible critics before they began (see for example Project Finance 2003). However, most large public investments have critics. In order to explain such a string of difficulties we need to look for other reasons. Therefore, it seems even more likely that the hypothetical example presented in the previous section is reflective of a serious real-world problem facing those who wish to bid on P3 projects today. Given the economic conditions in place, it is harder than it used to be to structure a P3 that provides the return investors are seeking and the useful value that the state is looking for. Pension managers looking for investment grade income vehicles might shy away from projects that they believe do not offer a reasonable level of useful value to the state. This will possibly be the case even if their public partners are willing to ignore useful value in order to advance political aims such as hiding debts off-balance-sheet, breaking unions, or more virtuously, a simple preference for market over public provision wherever feasible. This is because projects that are seen as wasteful or unfair (either to the state, users of the facilities that are created, taxpayers, or workers) will only lead to the sort of instability that pension managers are seeking to avoid by engaging in P3 deals (Lewis 2004).

Consequently, the question becomes how likely is it that the current less than ideal climate for P3s will endure? Three factors in particular are worth noting. First, the American government is running up massive deficits, which sooner or later, will accelerate the gradual rise in US interest rates. US Treasury bonds serve as a global benchmark, the least risky investment in the world against which the risk premiums for all other investments are set (Economist 2004). Therefore, events in the US are likely to produce interest rates in Canada that will be higher than otherwise warranted. Since rising interest rates are meant to slow the economy, the risk premium on corporate debt over government issues will also go up, but P3s might be somewhat protected from this, due to the fact that they deliver

essential services (Athanasakos and Carayannopoulos 2001).

Second, the P3 is not the only alternative financial product that has been invented to meet the needs of investors seeking greater opportunities to earn income. For example, at \$85 billion, the Canadian market for income trusts is five times larger than that for P3s (Calder 2004; Scofield and Church 2004: B6). In an income trust arrangement, a company separates its operations from its finances. The financial arm, or trust, operates like a mutual fund. It takes in investors' money and loans it to the operations arm. The loan is then repaid out of its earnings and these are distributed to investors in the trust. In that this transforms profits into a cost of doing business, it also eliminates most corporate income taxes owed by the firm. Meanwhile, the trust itself is a mutual fund, and as such, also pays no income tax provided all profits are distributed to unit holders. Taxes are then only paid by the investor receiving the distributed income from the trust. In that many investors (such as pension funds and individuals holding their investments in personal retirement accounts) are tax-exempt, this bit of financial engineering increases returns substantially. The problem is that in order to qualify for this tax break, the trust has to be an "unlimited" company. This means investors are 100 percent responsible for any losses, not just to the limit of their investment. Secondly, in the past, Ottawa has tried to discourage pension funds from being involved in this market. Due to pressure from pension managers, both barriers are being swept away as this paper is being written (Hayward 2002; Scofield and Church 2004). This will open wide swathes of the Canadian economy to pension funds seeking income investments, creating further competition for the cash needed to fund P3s, and further raising their cost.

The final factor to consider is "newness". Earlier, P3s were easier to arrange on favourable terms due to public ignorance (as to the issues and costs involved) and an underestimation by private managers of the difficulties involved in partnering with the public. In Ontario, the 407 toll highway and the Toronto Hospital (now University Health Network) both previously seen as successes (Fell 2002), have since fallen into difficulty (Standard & Poor's 2004a and 2004b). Meanwhile, the most ambitious P3 ever contemplated in Canada, the breaking up of Ontario Hydro, turned into a nightmare for the public, government, and investors alike (see for example Vieira and Benzie 2003). Opposition parties, non-partisan watchdogs (such as auditors), and civil society groups learned from these mistakes and are asking not only the tough questions but also the correct ones. This is making it all the more difficult to develop public support for P3s unless both the state and its private partners agree to greater levels of public disclosure. This is something that private organizations might not feel comfortable with (Poschmann 2003: 2).¹⁴

As a result, it is hard to see the sort of environment that helped create the golden age of Canadian P3s returning any time soon. It cannot be doubted that P3s are here to stay, and several more will be put in place over the coming years. However, given the previously noted change in economic conditions, the increasing availability of other income investment vehicles, and the increasing public awareness of the benefits and potential costs of this model, it is likely that this is an epilogue for P3s as a fetish. This is the case whether one uses the term in the sense of an irrational characterization of value or as a *de rigueur* reform.

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1 It should be emphasized that the discussion here only touches on the literature that seeks to explain how P3s became a "fetish" or "de rigueur reform". There is another literature that seeks to explain P3s as a neutral financial technology that serves specific public sector needs and ought to be employed when and where appropriate. The final report of the British Institute for Public Policy Research's "Commission on Public Private Partnerships," is one of the better of these studies. However, even the IPPR report admits that, in the past, the Blair led Labour government has sometimes appeared to have been using P3s as a means to massage its balance sheet (Taylor et al. 2001: 80).

2 When a government becomes displeased with a P3, there are many things it can do to force its private partner to re-negotiate, even if the partner comes under the protection of treaties such as NAFTA. For example, the simple existence of such displeasure creates risk for investors. Therefore, if the financial markets become aware of it, the securities issued to finance the project will be discounted, causing at least temporary losses to their holders. If the government goes out of its way to demonstrate its displeasure, such as by publicly threatening legal action, then the losses will be worse. Just such a threat by Ontario against the owners of the 407 highway led Standard & Poor's (2004a) to place the firm on "credit watch with negative implications".

3 The credit quality of organizations issuing debt and the individual debt issues themselves are generally divided into two categories, "investment grade" and "non-investment grade". As the names imply, the former ought to be suitable as long-term investments and present little risk of default. The latter category does not. Many pension funds either tightly limit their exposure to non-investment grade debt or refuse to hold it altogether. Different ratings agencies have different ratings schemes for differentiating credit quality. Standard & Poor's (2002) issues credit ratings for long-term debt on a scale from "AAA" to "C". A credit rating below BBB is non-investment grade "+"

or “-“ symbols after the ranking indicate comparison to other issuers and issues within the given rank. A rating of “D” means the organization is in default.

4 In the late 1990s, pension managers lobbied the federal government intensively to have the figure raised from 20 percent (Carrick 1997).

5 For example, when Toronto Hospital issued \$280 Million in bonds in 1998 the offering memorandum tied use of the money to a specific renovation project and gave bondholders the right of approval over any changes in the structure of the hospital, mergers, or major asset disposals outside of this project (Toronto Hospital 1998: 28-29). In that the hospital is Ontario’s largest health facility, this amounts to a defacto right of veto over any future restructuring and health reform efforts in the greater Toronto area until the bonds are paid off.

6 Applications by firms wishing to serve as primary dealers are evaluated by the Bank of Canada. The Bank of Canada assesses a firm’s ability to effectively take part in the auctioning of federal government bonds and their ability to make a secondary market in the bonds. The process noted here, of course, excludes Canada Savings Bonds. These are special products sold to individual savers either directly or through retail financial institutions. In the United States, anyone can bid to buy bonds from the government; however, firms designated as primary dealers by the Federal Reserve enjoy advantages in terms of market information, make the lion’s share of the bids, and dominate trading in the secondary market (Bank of Canada 1998; Dupont and Sack 1999).

7 An example of this was the aborted attempt to convert Toronto’s Pearson airport into a P3 in 1993. The contract, if allowed to stand, would have obliged the Canadian government to compensate the private partners if the government allowed any further development at airports within 75 KM that drew passengers away from Pearson (Weston 1993).

8 The main change was to reduce the amount of tunneling bidders would be expected to do, and therefore would expose more residents to the disruptive noise and eyesore of an elevated rapid transit line running directly in front of their homes (GVTA 2004).

9 Sometimes a firm will find itself with unanticipated cash on hand and use it to make an unanticipated dividend payment to shareholders. However, the management of such a firm also generally reminds shareholders that this is unusual and might not even call it a dividend at all, but rather, a “special dividend” or even a “special distribution”. In the spring of 2004, financial speculation turned to whether Microsoft might be preparing to make such a payout (Savitz 2004). The company indeed did so in the summer of 2004 (Microsoft 2004).

10 By an “all other things being equal basis” is meant that the infrastructure or service involved is of the same quality as the purely public infrastructure or services it replaces. Otherwise, the P3 is just a veil for cutbacks. Similarly, if the savings are delivered by cutting the wages and benefits of workers, rather than say investments in technology that improve the productivity of said workers, then the P3 is once again just collecting a fee for doing the government’s dirty work, rather than delivering useful value to the state and public.

11 The yield spread between federal and corporate bonds would be commensurately wider, making the task facing our hypothetical consortium that much tougher.

12 This index was designed to serve as a benchmark for the Canadian investment grade corporate bond market.

13 The calculation is present interest rate minus past interest rate over past interest rate multiplied by 100. In equation format .

14 To illustrate the point made here, the report from Macquarie North America (2001) cited extensively in this paper amounts to little more than a summary of the literature on P3s, some relatively general advice (such as ways risk was managed in other contracts), examples of best practices, and the recommendation that the P3 format might be suitable for the proposed Vancouver Airport rapid transit line. Nevertheless it was stamped “Confidential”.